

Tennessee Local Development Authority

**For the Year Ended
June 30, 1998**

Arthur A. Hayes, Jr., CPA
Director

Barbara K. White, CPA
Assistant Director

Teresa L. Hensley, CPA
Audit Manager

Cynthia S. Singleton
In-Charge Auditor

Conchata Brown
Jim Ehmann, CPA
Kathy Gabriel
Melinda Edinbugh
Jennifer Thomason
Staff Auditors

Erica V. Smith, CPA
Technical Analyst

Jane Russ
Editor

April 12, 1999

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable John G. Morgan
Comptroller of the Treasury
Secretary of the Tennessee Local Development Authority
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Local Development Authority for the year ended June 30, 1998. You will note from the independent auditor's report that a qualified opinion was given on the fairness of the presentation of the financial statements. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/km
98/118

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Tennessee Local Development Authority
For the Year Ended June 30, 1998

AUDIT OBJECTIVES

The objectives of the audit were to consider the authority's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts (including bond resolutions); to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is qualified. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 741-3697

Audit Report
Tennessee Local Development Authority
For the Year Ended June 30, 1998

TABLE OF CONTENTS

	<u>Exhibit</u>	<u>Page</u>
INTRODUCTION		1
Post-Audit Authority		1
Legislative History		1
Organization		1
AUDIT SCOPE		2
OBJECTIVES OF THE AUDIT		2
PRIOR AUDIT FINDINGS		4
RESULTS OF THE AUDIT		4
Audit Conclusions		4
Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>		5
FINANCIAL STATEMENTS		
Independent Auditor's Report		7
Balance Sheets	A	9
Statements of Revenues, Expenses, and Changes in Retained Earnings	B	10
Statements of Cash Flows	C	11
Notes to the Financial Statements		12

TABLE OF CONTENTS (CONT.)

	<u>Exhibit</u>	<u>Page</u>
SUPPLEMENTARY INFORMATION		
Supplementary Balance Sheets – Program Level	D	19
Supplementary Statements of Revenues, Expenses, and Changes in Retained Earnings – Program Level	E	20
Supplementary Statements of Cash Flows – Program Level	F	21

Tennessee Local Development Authority For the Year Ended June 30, 1998

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Local Development Authority. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

LEGISLATIVE HISTORY

The Tennessee Local Development Authority was created April 2, 1978, by an act of the General Assembly, codified as Title 4, Chapter 31, *Tennessee Code Annotated*. The authority is delegated the responsibility for issuing its debt obligations to provide funds to make loans to local governments for the State Loan Programs and for capital projects; certain small business concerns for pollution control facilities; farmers for certain capital improvements; counties for the acquisition of equipment for use by county or volunteer fire departments serving unincorporated areas of the counties; airport authorities and municipal airports; and mental health/mental retardation/alcohol and drug facilities (the Community Provider Pooled Loan Program”). To date, the authority has issued debt only to fund the State Loan Programs and the Community Provider Pooled Loan Program.

ORGANIZATION

The Tennessee Local Development Authority is composed of the Governor, the Secretary of State, the Comptroller of the Treasury, the State Treasurer, the Commissioner of Finance and Administration, and two other members—one appointed by the Speaker of the Senate from nominations by the Tennessee County Services Association and the other by the Speaker of the House from nominations by the Tennessee Municipal League. The Governor serves as Chairman, and the Comptroller of the Treasury serves as secretary.

An organization chart for the Tennessee Local Development Authority is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 1997, through June 30, 1998, and was conducted in accordance with generally accepted government auditing standards except as indicated in the Independent Auditor's Report. Financial statements are presented for the year ended June 30, 1998, and for comparative purposes, the year ended June 30, 1997. The Tennessee Local Development Authority has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

The audit covered allotment code 307.07—Division of Bond Finance (Fund 34).

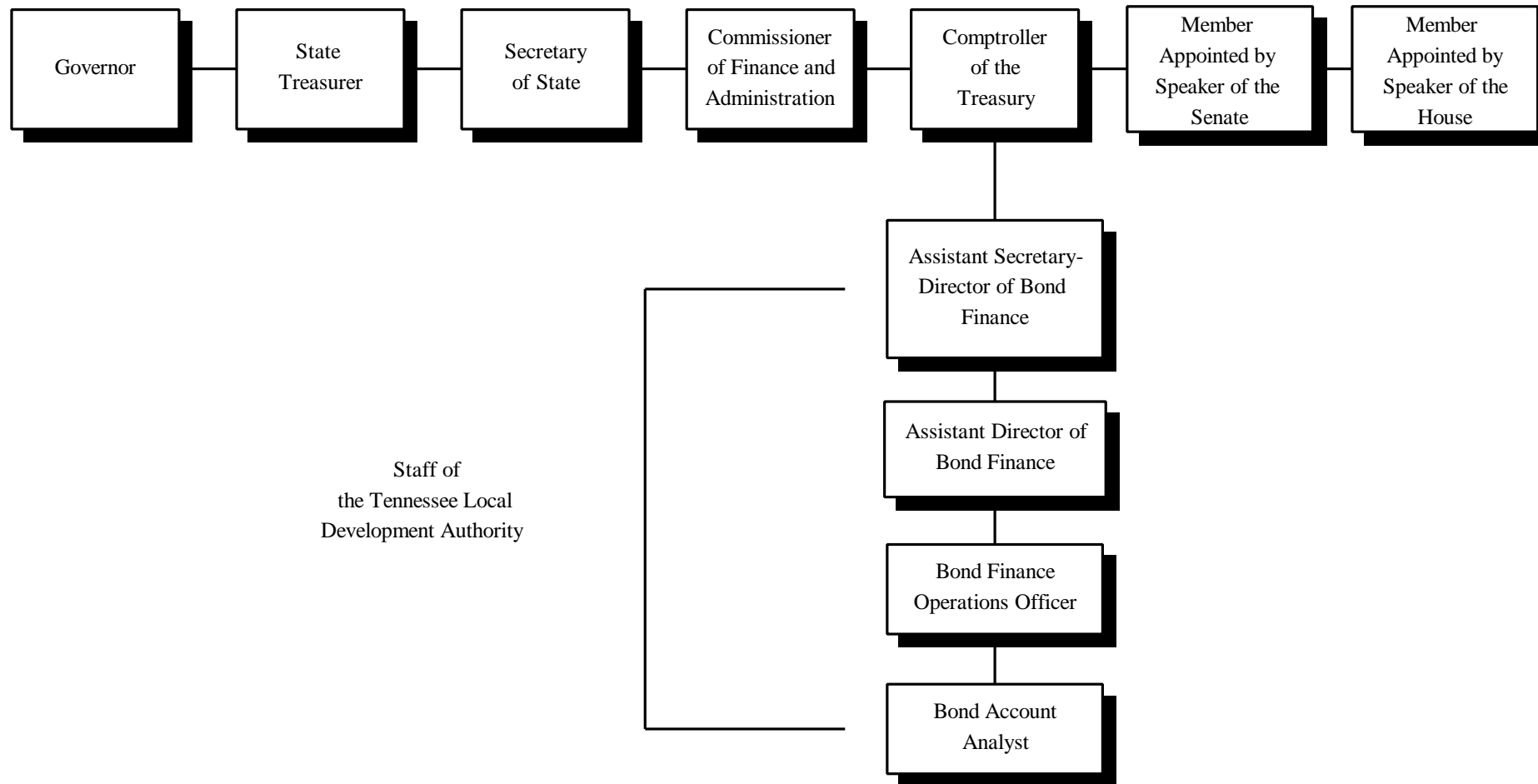
OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the authority's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, and contracts (including bond resolutions);
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

Tennessee Local Development Authority



PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Tennessee Local Development Authority's financial statements for the year ended June 30, 1998, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered a qualified opinion on the Tennessee Local Development Authority's financial statements. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Accordingly, insufficient audit evidence exists to support the authority's disclosures with respect to the year 2000 issue made in Note 8.

**Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

January 22, 1999

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the Tennessee Local Development Authority, a component unit of the State of Tennessee, as of and for the year ended June 30, 1998, and have issued our report thereon dated January 22, 1999. Our report was qualified. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Accordingly, insufficient audit evidence exists to support the authority's disclosures with respect to the year 2000 issue made in Note 8.

Except as discussed in the preceding paragraph, we conducted our audit in accordance with generally accepted government auditing standards.

Compliance

As part of obtaining reasonable assurance about whether the authority's financial statements are free of material misstatement, we performed tests of the authority's compliance with certain provisions of laws, regulations, and contracts (including bond resolutions), noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The

The Honorable John G. Morgan
January 22, 1999
Page Two

results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/km

Independent Auditor's Report

January 22, 1999

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying balance sheets of the Tennessee Local Development Authority, a component unit of the State of Tennessee, as of June 30, 1998, and June 30, 1997, and the related statements of revenues, expenses, and changes in retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the authority's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

Except as discussed in the following paragraph, we conducted our audits in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Governmental Accounting Standards Board (GASB) Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*, requires disclosure of certain matters regarding the year 2000 issue. The authority has included such disclosures in Note 8. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully

The Honorable John G. Morgan
January 22, 1999
Page Two

determinable until the year 2000 and thereafter. Accordingly, insufficient audit evidence exists to support the authority's disclosures with respect to the year 2000 issue made in Note 8. Further, we do not provide assurance that the authority is or will be year 2000 ready, that the authority's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the authority does business will be year 2000 ready.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding year 2000 disclosures, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Local Development Authority, as of June 30, 1998, and June 30, 1997, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 7 to the financial statements, the Tennessee Local Development Authority implemented GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, in conformity with generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the financial statements, taken as a whole. The accompanying financial information, following the notes to the financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding year 2000 disclosures, is fairly stated in all material respects in relation to the financial statements, taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 22, 1999, on our consideration of the authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts (including bond resolutions).

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/km

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
BALANCE SHEETS
JUNE 30, 1998, AND JUNE 30, 1997

(Expressed in Thousands)

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
<u>ASSETS</u>		
Current assets:		
Cash (Note 2)	\$ 28,789	\$ 15,355
Receivables:		
Principal due from borrowers	5,470	4,875
Interest due from borrowers	24	42
Investments	-	8,649
Interest receivable on investments	58	235
	<u>34,341</u>	<u>29,156</u>
Total current assets		
Restricted assets (Notes 2 and 3):		
Cash	7,362	-
Investments	3,153	9,642
	<u>10,515</u>	<u>9,642</u>
Total restricted assets		
Other assets:		
Principal due from borrowers	85,467	85,112
Deferred charges	425	229
	<u>85,892</u>	<u>85,341</u>
Total other assets		
Total assets	\$ <u><u>130,748</u></u>	\$ <u><u>124,139</u></u>
<u>LIABILITIES AND EQUITY</u>		
Liabilities:		
Current liabilities:		
Warrants payable	\$ 3	\$ -
Accrued interest payable	1,652	1,582
Payable to borrowers (Note 4)	1,093	1,130
Notes payable (Note 5)	26,059	32,600
Revenue bonds payable (Note 5)	5,470	4,875
	<u>34,277</u>	<u>40,187</u>
Total current liabilities		
Noncurrent liabilities:		
Revenue bonds payable, net (Note 5)	85,233	74,516
	<u>119,510</u>	<u>114,703</u>
Total liabilities		
Equity:		
Retained earnings - reserved for statutory fund	6,000	5,817
Retained earnings - unreserved	5,238	3,619
	<u>11,238</u>	<u>9,436</u>
Total equity		
Total liabilities and equity	\$ <u><u>130,748</u></u>	\$ <u><u>124,139</u></u>

The Notes to the Financial Statements are an integral part of this statement.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
 STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS
 FOR THE YEARS ENDED JUNE 30, 1998, AND JUNE 30, 1997

(Expressed in Thousands)

	Year Ended June 30, 1998	Year Ended June 30, 1997
<u>OPERATING REVENUES</u>		
Charges for services	\$ 5,422	\$ 5,410
Investment income:		
Interest	1,692	2,144
Net increase in the fair value of investments	<u>33</u>	<u>-</u>
Total operating revenues	<u>7,147</u>	<u>7,554</u>
<u>OPERATING EXPENSES</u>		
Interest expense	5,307	6,656
Bond issuance cost	22	16
Administrative expense	<u>34</u>	<u>139</u>
Total operating expenses	<u>5,363</u>	<u>6,811</u>
Operating income before operating transfer	1,784	743
Operating transfer from primary government	<u>25</u>	<u>25</u>
Net income	<u>1,809</u>	<u>768</u>
Retained earnings, July 1	9,436	8,668
Cumulative effect of a change in accounting principle (Note 7)	<u>(7)</u>	<u>-</u>
Retained earnings, July 1, as restated	<u>9,429</u>	<u>8,668</u>
Retained earnings, June 30	\$ <u><u>11,238</u></u>	\$ <u><u>9,436</u></u>

The Notes to the Financial Statements are an integral part of this statement.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 1998, AND JUNE 30, 1997

(Expressed in Thousands)

	Year Ended June 30, 1998	Year Ended June 30, 1997
Cash flows from operating activities:		
Operating income before operating transfer	\$ 1,784	\$ 743
Adjustments to reconcile operating income to net cash used by operating activities:		
Amortization	22	16
Charges for services	(5,422)	(5,410)
Investment income	(1,725)	(2,519)
Interest expense	5,307	6,656
Increase in warrants payable	3	-
Decrease in accounts payable	-	(108)
Increase (decrease) in payable to borrowers	(37)	227
Total adjustments	(1,852)	(1,138)
Net cash used by operating activities	(68)	(395)
Cash flows from noncapital financing activities:		
Proceeds from sale of notes	26,065	32,609
Proceeds from sale of bonds	37,112	-
Refunding bond proceeds to escrow	(37,852)	-
Funds received from escrow	18,519	-
Payments for escrow	(18,519)	-
Principal payments	(20,750)	(49,600)
Interest paid	(5,392)	(6,909)
Operating transfer from primary government	25	25
Net cash used by noncapital financing activities	(792)	(23,875)
Cash flows from investing activities:		
Loans issued	(11,687)	(4,569)
Collections of loan principal	11,248	10,974
Interest received on loans	5,029	5,458
Interest received on investments	1,901	2,421
Proceeds from maturity of investments	16,169	-
Purchase of investments	(1,004)	(8,394)
Net cash provided by investing activities	21,656	5,890
Net increase (decrease) in cash	20,796	(18,380)
Cash, July 1	15,355	33,735
Cash, June 30	\$ 36,151	\$ 15,355
Noncash financing activities:		
Bond issuance costs	\$ 576	\$ -

The Notes to the Financial Statements are an integral part of this statement.

Tennessee Local Development Authority
Notes to the Financial Statements
June 30, 1998, and June 30, 1997

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Tennessee Local Development Authority was created to provide financing assistance to local governments through the issuance of revenue bonds or notes. The authority also issues bonds to assist nonprofit corporations in the construction of mental health, mental retardation, or alcohol and drug facilities. In accordance with the Governmental Accounting Standards Board's Statement 14, the authority is reported as a discretely presented component unit in the *Tennessee Comprehensive Annual Financial Report*. Although the authority is a separate legal entity, its board consists primarily of state officials, and therefore, the state has the ability to affect the day-to-day operations of the authority.

Basis of Presentation

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Tennessee Local Development Authority follows all applicable GASB pronouncements as well as applicable private-sector pronouncements issued on or before November 30, 1989.

Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

Investments

Effective July 1, 1997, investments are stated at fair value. Prior to this date, investments were stated at cost or amortized cost.

Bond Discounts and Issuance Costs

Bond discounts and issuance costs are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable unamortized bond discount. Unamortized issuance costs are reported as deferred charges.

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 1998, and June 30, 1997

NOTE 2. DEPOSITS AND INVESTMENTS

Deposits. Under the general bond resolution of the Tennessee Local Development Authority, the funds of the authority are to be deposited with the State Treasurer and can be invested in any security deemed acceptable to Treasury standards.

The authority had \$36,151,052 in the State Treasurer's pooled investment fund at June 30, 1998, and \$15,355,047 at June 30, 1997.

The pooled investment fund administered by the State Treasurer is authorized by state statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and agency obligations, and obligations of the State of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The pooled investment fund is also authorized to enter into securities lending agreements in which U.S. government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Treasurer's pooled investment fund's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report*.

Investments. Investments are required to be categorized to indicate the level of custodial risk assumed by the authority. All of the authority's investments are category 1, which consists of investments that are insured or registered or for which the securities are held by the authority or its agent in the authority's name.

Authority investments at June 30, 1998, are categorized below (expressed in thousands):

	<u>Category 1</u>
	<u>Fair</u>
	<u>Value</u>
U.S. Treasury Notes	\$1,692
U.S. Treasury Securities—	
State and Local Government Series	<u>1,461</u>
Total investments	<u><u>\$3,153</u></u>

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 1998, and June 30, 1997

Authority investments at June 30, 1997, are categorized below (expressed in thousands):

	Category 1	
	Carrying <u>Amount</u>	Market <u>Value</u>
U.S. Treasury Notes	\$7,187	\$7,177
U.S. Treasury Securities— State and Local Government Series	1,461	1,461
Federal National Mortgage Association Securities	1,323	1,327
Municipal Notes	<u>8,320</u>	<u>8,320</u>
Total investments	<u>\$18,291</u>	<u>\$18,285</u>

NOTE 3. RESTRICTED ASSETS

The general bond resolution of the authority requires that the principal of each bond issue include an amount equal to one year's debt service requirement and that such amount be placed in special trust accounts with the trustee. The required debt service reserve was \$10,514,889 at June 30, 1998, and \$9,641,943 at June 30, 1997.

NOTE 4. PAYABLE TO BORROWERS

This account represents interest earnings on restricted assets and loan principal overpayments that will be refunded to borrowers.

NOTE 5. NOTES AND BONDS PAYABLE

Notes. Notes payable at June 30, 1998, and June 30, 1997, are as follows (expressed in thousands):

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 1998, and June 30, 1997

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
Revenue bond anticipation notes 3.690% issued May 20, 1998, maturing May 19, 1999, (includes unamortized premium of \$59)	\$ 26,059	\$ -
Revenue bond anticipation notes 3.860% issued May 29, 1997, maturing May 29, 1998, (includes unamortized premium of \$100)	<u>-</u>	<u>32,600</u>
Total notes payable	<u>\$ 26,059</u>	<u>\$ 32,600</u>

Revenue bonds. Bonds payable at June 30, 1998, and June 30, 1997, are as follows(expressed in thousands):

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
Refunding revenue bonds, 4.0% to 7.25%, issued January 14, 1987, due in various amounts of principal and interest from \$.2 million in 1999 to \$.9 million in 2015 (net of unamortized discount of \$802 at June 30, 1998, and \$850 at June 30, 1997)	\$ 3,520	\$ 3,471
Revenue bonds, 4.65% to 7.0%, issued July 16, 1991, due in decreasing amounts of principal and interest from \$2.0 million in 1999 to \$.1 million in 2021	-	19,515
Revenue bonds, 5.4% to 7.0%, issued January 7, 1992, due in decreasing amounts of principal and interest from \$1.3 million in 1999 to \$.7 million in 2022	12,050	12,565
Refunding revenue bonds, 2.5% to 5.75%, issued July 7, 1993, due in various amounts of principal and interest from \$4.6 million in 1999 to \$2.1 million in 2011	28,625	31,890

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 1998, and June 30, 1997

	<u>June 30, 1998</u>	<u>June 30, 1997</u>
Revenue bonds, 4.0% to 6.55%, issued June 29, 1994, due in decreasing amounts of principal and interest from \$1.1 million in 1999 to \$.3 million in 2024	11,505	11,950
Refunding revenue bonds, 4.75% to 5.125%, issued November 1, 1997, due in various amounts of principal and interest from \$3.3 million in 1999 to \$.015 million in 2022 (net of unamortized discount of \$73 and deferred amount on refunding of \$1,789 at June 30, 1998)	<u>35,003</u>	<u>-</u>
Total bonds payable	<u>\$ 90,703</u>	<u>\$ 79,391</u>

Debt service requirements to maturity of the revenue bonds payable at June 30, 1998, are as follows (expressed in thousands):

For the Year(s) <u>Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
1999	\$ 5,470	\$ 5,045	\$ 10,515
2000	5,735	4,776	10,511
2001	4,955	4,485	9,440
2002	5,210	4,229	9,439
2003	5,235	3,963	9,198
2004-2024	<u>66,761</u>	<u>29,406</u>	<u>96,167</u>
Total	<u>\$ 93,366</u>	<u>\$ 51,904</u>	<u>\$145,270</u>

NOTE 6. REFUNDING

On November 1, 1997, the Tennessee Local Development Authority issued \$37,385,000 of State Loan Program Revenue Bonds, 1997 Series A to refund the 1991 Bonds and a portion of the 1997 Series A Bond Anticipation Notes. Net proceeds of \$37.3 million, which includes an original issue discount, combined with

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 1998, and June 30, 1997

other funds available to the authority, were used to purchase escrows to redeem the 1991 bonds on March 1, 2000, and a portion of the 1997 notes on May 28, 1998.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$1.8 million. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2021 using the straight-line method. The authority completed the refunding to reduce its total debt service payments over the next 23 years by \$3.6 million and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$1.5 million.

NOTE 7. ACCOUNTING CHANGE

During the year ended June 30, 1998, the authority implemented GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, which requires reporting certain investments at fair value. Changes in the fair value of investments (unrealized gains and losses) are recognized as revenue in the operating statement and are not separated from realized gains and losses.

The cumulative effect of this change in accounting principle is reported in the accompanying financial statements as a restatement of the beginning retained earnings. Not all information was available to restate prior periods to conform to this accounting change.

NOTE 8. YEAR 2000 DISCLOSURE

The Year 2000 Issue (Y2K) arises because most computer software programs allocate two digits to the data field for year on the assumption that the first two digits will be 19. Such programs will thus interpret the year 2000 as the year 1900, the year 2001 as 1901, etc. Absent reprogramming Y2K affects both computer hardware (i.e., the embedded logic of computer chips) and computer software and could affect both the ability to enter data into the computer programs and the ability of such programs to correctly process data. Y2K affects the computer applications and other equipment of the authority and its vendors, investment providers, and bond trustees.

The state has completed its assessment of Y2K and has determined that certain computer applications are mission critical, certain are critical, and certain are

Tennessee Local Development Authority
Notes to the Financial Statements (Cont.)
June 30, 1998, and June 30, 1997

supportive. Mission-critical computer applications are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the state from fulfilling its mission. Critical computer applications are those for which there are manual alternatives, but the state would unlikely be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer applications are those for which there are manual alternatives, and the state expects to be able to perform such functions manually, if necessary.

The authority has identified one mission-critical application that is dependent on the state. The authority relies principally upon the State of Tennessee Accounting and Reporting System (STARS) administered by the state's Department of Finance and Administration. As of June 30, 1998, the STARS system had reportedly completed the awareness and assessment stages and was near completion of the remediation stage. The state considers remediation, in this context, to mean either the successful conversion of an existing computer application or the replacement of an existing application with a new application. The state is continuing the remediation and testing of the STARS system. In addition, the state is in the process of assessing the Y2K effect on other equipment. The state is not presently aware of any noncompliance by its yet untested mission-critical and critical computer applications and other equipment or of any costs to achieve Y2K compliance that will have a material negative impact on the state's operations or financial status; however, the state can give no assurance that circumstances will not change.

The authority's Y2K initiatives did not result in the commitment of significant financial resources as of the end of the authority's reporting period.

The state has begun soliciting information from other organizations whose Y2K compliance could affect the state regarding the status of their assessment, testing, and remediation of their computer applications and other equipment. Of the organizations that have responded to date, all expect to achieve compliance in a manner that will not have a materially negative effect on the state's operations or financial status, although no assurances can be given that circumstances will not change. The state does not have full and complete information, however, from these other organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the state's operations or financial status.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
SUPPLEMENTARY BALANCE SHEETS - PROGRAM LEVEL
JUNE 30, 1998, AND JUNE 30, 1997

(Expressed in Thousands)						
	June 30, 1998			June 30, 1997		
	State Loan Program	Community Provider Program	Total	State Loan Program	Community Provider Program	Total
ASSETS						
Current assets:						
Cash	\$ 27,288	\$ 1,501	\$ 28,789	\$ 13,741	\$ 1,614	\$ 15,355
Receivables:						
Principal due from borrowers	4,465	1,005	5,470	3,920	955	4,875
Interest due from borrowers	22	2	24	26	16	42
Investments	-	-	-	8,571	78	8,649
Interest receivable on investments	58	-	58	206	29	235
Total current assets	31,833	2,508	34,341	26,464	2,692	29,156
Restricted assets:						
Cash	6,061	1,301	7,362	-	-	-
Investments	1,966	1,187	3,153	7,152	2,490	9,642
Total restricted assets	8,027	2,488	10,515	7,152	2,490	9,642
Other assets:						
Principal due from borrowers	66,027	19,440	85,467	64,682	20,430	85,112
Deferred charges	425	-	425	229	-	229
Total other assets	66,452	19,440	85,892	64,911	20,430	85,341
Total assets	\$ 106,312	\$ 24,436	\$ 130,748	\$ 98,527	\$ 25,612	\$ 124,139
LIABILITIES AND EQUITY						
Liabilities:						
Current liabilities:						
Warrants payable	\$ -	\$ 3	\$ 3	\$ -	\$ -	\$ -
Accrued interest payable	1,274	378	1,652	1,192	390	1,582
Payable to borrowers	875	218	1,093	642	488	1,130
Notes payable	26,059	-	26,059	32,600	-	32,600
Revenue bonds payable	4,465	1,005	5,470	3,920	955	4,875
Total current liabilities	32,673	1,604	34,277	38,354	1,833	40,187
Noncurrent liabilities:						
Revenue bonds payable, net	62,683	22,550	85,233	50,956	23,560	74,516
Total liabilities	95,356	24,154	119,510	89,310	25,393	114,703
Equity:						
Retained earnings - reserved for statutory fund	6,000	-	6,000	5,817	-	5,817
Retained earnings - unreserved	4,956	282	5,238	3,400	219	3,619
Total equity	10,956	282	11,238	9,217	219	9,436
Total liabilities and equity	\$ 106,312	\$ 24,436	\$ 130,748	\$ 98,527	\$ 25,612	\$ 124,139

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
SUPPLEMENTARY STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN RETAINED EARNINGS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 1998, AND JUNE 30, 1997

(Expressed in Thousands)						
	Year Ended June 30, 1998			Year Ended June 30, 1997		
	State Loan Program	Community Provider Program	Total	State Loan Program	Community Provider Program	Total
OPERATING REVENUES						
Charges for services	\$ 4,095	\$ 1,327	\$ 5,422	\$ 4,288	\$ 1,122	\$ 5,410
Investment income:						
Interest	1,456	236	1,692	1,890	254	2,144
Net increase in the fair value of investments	31	2	33	-	-	-
Total operating revenues	<u>5,582</u>	<u>1,565</u>	<u>7,147</u>	<u>6,178</u>	<u>1,376</u>	<u>7,554</u>
OPERATING EXPENSES						
Interest expense	3,785	1,522	5,307	5,083	1,573	6,656
Bond issuance cost	22	-	22	16	-	16
Administrative expense	34	-	34	139	-	139
Total operating expenses	<u>3,841</u>	<u>1,522</u>	<u>5,363</u>	<u>5,238</u>	<u>1,573</u>	<u>6,811</u>
Operating income (loss) before operating transfer	1,741	43	1,784	940	(197)	743
Operating transfer from primary government	25	-	25	25	-	25
Net income (loss)	<u>1,766</u>	<u>43</u>	<u>1,809</u>	<u>965</u>	<u>(197)</u>	<u>768</u>
Retained earnings, July 1	9,217	219	9,436	8,252	416	8,668
Cumulative effect of a change in accounting principle	(27)	20	(7)	-	-	-
Retained earnings, July 1, as restated	<u>9,190</u>	<u>239</u>	<u>9,429</u>	<u>8,252</u>	<u>416</u>	<u>8,668</u>
Retained earnings, June 30	<u>\$ 10,956</u>	<u>\$ 282</u>	<u>\$ 11,238</u>	<u>\$ 9,217</u>	<u>\$ 219</u>	<u>\$ 9,436</u>

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
SUPPLEMENTARY STATEMENTS OF CASH FLOWS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 1998, AND JUNE 30, 1997

	(Expressed in Thousands)					
	Year Ended June 30, 1998			Year Ended June 30, 1997		
	State Loan Program	Community Provider Program	Total	State Loan Program	Community Provider Program	Total
Cash flows from operating activities:						
Operating income (loss) before operating transfer	\$ 1,741	\$ 43	\$ 1,784	\$ 940	\$ (197)	\$ 743
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:						
Amortization	22	-	22	16	-	16
Charges for services	(4,095)	(1,327)	(5,422)	(4,288)	(1,122)	(5,410)
Investment income	(1,487)	(238)	(1,725)	(2,265)	(254)	(2,519)
Interest expense	3,785	1,522	5,307	5,083	1,573	6,656
Increase in warrants payable	-	3	3	-	-	-
Decrease in accounts payable	-	-	-	(108)	-	(108)
Increase (decrease) in payable to borrowers	233	(270)	(37)	(42)	269	227
Total adjustments	(1,542)	(310)	(1,852)	(1,604)	466	(1,138)
Net cash provided (used) by operating activities	199	(267)	(68)	(664)	269	(395)
Cash flows from noncapital financing activities:						
Proceeds from sale of notes	26,065	-	26,065	32,609	-	32,609
Proceeds from sale of bonds	37,112	-	37,112	-	-	-
Refunding bond proceeds to escrow	(37,852)	-	(37,852)	-	-	-
Funds received from escrow	18,519	-	18,519	-	-	-
Payments for escrow	(18,519)	-	(18,519)	-	-	-
Principal payments	(19,790)	(960)	(20,750)	(48,630)	(970)	(49,600)
Interest paid	(3,857)	(1,535)	(5,392)	(5,324)	(1,585)	(6,909)
Operating transfer from primary government	25	-	25	25	-	25
Net cash provided (used) by noncapital financing activities	1,703	(2,495)	(792)	(21,320)	(2,555)	(23,875)
Cash flows from investing activities:						
Loans issued	(11,637)	(50)	(11,687)	(4,403)	(166)	(4,569)
Collections of loan principal	10,268	980	11,248	10,000	974	10,974
Interest received on loans	3,697	1,332	5,029	4,337	1,121	5,458
Interest received on investments	1,617	284	1,901	2,163	258	2,421
Proceeds from maturity of investments	14,765	1,404	16,169	-	-	-
Purchase of investments	(1,004)	-	(1,004)	(8,320)	(74)	(8,394)
Net cash provided by investing activities	17,706	3,950	21,656	3,777	2,113	5,890
Net increase (decrease) in cash	19,608	1,188	20,796	(18,207)	(173)	(18,380)
Cash, July 1	13,741	1,614	15,355	31,948	1,787	33,735
Cash, June 30	\$ 33,349	\$ 2,802	\$ 36,151	\$ 13,741	\$ 1,614	\$ 15,355
Noncash financing activities:						
Bond issuance costs	\$ 576	\$ -	\$ 576	\$ -	\$ -	\$ -